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Nos. 80-1012, 80-1030, 80-1052

IN THE

Supreme Court of the United States

October Term, 1980

BAXTER RICE, Director, Department of Alcoholic Beverage Control of the State of California, *et al.*,
Petitioners,

v.

NORMAN WILLIAMS COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate Division

BRIEF OF *AMICI CURIAE* WINE AND SPIRITS WHOLESALERS OF AMERICA, INC. AND NATIONAL BEER WHOLESALERS ASSOCIATION OF AMERICA, INC. IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

PAGE

Interest of *Amici Curiae* 1

Statement 3

Summary of Argument 10

Argument

I—The State Court's Decision Striking Down, on Its Face, the California Designated Wholesaler/Primary Source Statute Because of Alleged Conflict with the Federal Antitrust Laws Is Patently Erroneous and Should Be Reversed 13

A. The Statute Neither Requires nor Authorizes Any Violation of the Sherman Act, *Per se* or Otherwise 13

B. Because the Statute Compels No Action by Private Parties in *Per se* Violation of the Antitrust Laws, the State Court Erred in Finding It Repugnant to the Sherman Act 18

II—Even if in Violation of the Antitrust Laws, the Designation Statute Was a Valid Exercise of California's Virtually Complete Control Under the Twenty-first Amendment of the Importation and Structuring of the Distribution System for Intoxicating Beverages 22

Conclusion 28

TABLE OF AUTHORITIES

PAGE

Cases:

Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979) 16

California Retail Liquor Dealers Ass'n. v. Midcal Aluminum, Inc., 445 U.S. 97 (1980) 19
Capiscean Corp. v. Alcoholic Beverage Control Appeals Board, 87 Cal. App.3d 996, 151 Cal. Rptr. 492 (1979) 19
Colby Distributing Co., Inc. v. Lennen, 227 Kan.2d 179, 606 P.2d 102 (1980) 17, 18, 28
Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) ..... 3, *passim*

Dakota Wholesale Liquor, Inc. v. State of Minnesota, 457 F.Supp. 480 (D. Minn. 1978), *aff'd per curiam*, 584 F.2d 847 (8th Cir. 1978) 16

Grant Billingsley Wholesale Liquor Co., Inc. v. Lennen, 449 U.S. 943 (1980) 17, 28

H&H Distributing Company, Inc. v. Mississippi State Tax Commission, et al., Civil No. J80-0323(N), S.D. Miss. (Jackson Div.) 21
Heublein, Inc. v. South Carolina Tax Commission, 409 U.S. 275 (1972) 23
Hostetter v. Idlewild Liquor Corp., 377 U.S. 324 (1964) 23

Joseph E. Seagram & Sons, Inc. v. Hostetter, 384 U.S. 35 (1966) 19

Midcal Aluminum, Inc. v. Rice, 90 Cal. App.3d 979, 153 Cal. Rptr. 757 (1979) 19

PAGE

Mile Hi Wholesale Liquors, Inc. v. Alan Charnes, Executive Director of the Department of Revenue, State of Colorado, Case No. 80 C.V. 8844, Dist. Ct., City & County of Denver, State of Colorado 21

Naify v. McClatchy Newspapers, 599 F.2d 335 (9th Cir. 1979) 16

Rice v. Alcoholic Beverage Control Appeals Board, 21 Cal.3d 431, 146 Cal. Rptr. 585, 579 P.2d 476 (1978) 19

State Board v. Young's Market Co., 299 U.S. 59 (1936) 23

United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) 15, 17

Norman Williams Co. v. Rice, 108 Cal. App.3d 348, 166 Cal. Rptr. 563 (1980) ..... 2, *passim*

Statutes:

Cal. Bus. & Prof. Code, §23672 ..... 4, *passim*

Kan. Stats. Ann., §§41-101, *et seq.* 18

Minn. Stats. Ann., §§340.114, 340.145 10

Okla. Stats. Ann., Title 37, §§521(e), 533, 536.1 4

Robinson-Patman Act, §2(a) (15 U.S.C. §13) 17

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Interest of *Amici Curiae*

With the written consent of all parties, Wine and Spirits Wholesalers of America, Inc. ("WSWA") and National Beer Wholesalers Association of America, Inc. ("NBWA"), pursuant to Rule 36 of this Court, submit this brief as *amici curiae* in support of the petitioners.

As the major national trade associations for wholesale distributors of distilled spirits, wines and malt beverages, WSWA represents more than 800 members in 41 states and NBWA represents more than 1,800 members in 50 states.[1] Most of them conduct their distribution businesses pursuant to wholesale licenses issued by the "open" or "license" states (*i.e.*, those which permit the distribution of alcoholic beverages by private enterprise concerns as distinguished from the minority of "monopoly" or "closed" states in which the state itself operates the business of wholesaling one or more types of alcoholic beverage). Because the need for governmental regulation of beverage alcohol has been universally accepted, in these open states each separate level of the trade is subject to highly detailed but purposefully integrated regulatory complexes. Reflecting the individual policies of the particular state, these regulatory structures differ significantly from state to state and beverage to beverage.

The decision below, reported as *Norman Williams Co .v. Rice,* 108 Cal. App.3d 348, 166 Cal. Rptr. 563 (1980),[2] is of the utmost concern and importance to the members of WSWA and NBWA, because it constitutes a radical departure from controlling precedent and threatens both effective competition and existing governmental regulation not merely in California but in many other states, too. If not repudiated, the erroneous and far-reaching rationale adopted by the court below in striking down California's "designated wholesaler" or "primary source" requirement threatens similar statutes of the many other states where the members of WSWA and NBWA do business.

Williams, if adopted in other jurisdictions as a viable precedent, would presage the destruction of the franchised

1. Both *amici* are not-for-profit corporations.

2. The opinion appears as Appendix A to the Petition for Certiorari filed with the Court by Wine & Spirits Wholesalers of California, an intervenor below (No. 80-1030). Citations to that opinion in this brief will be by reference to the page numbers of Appendix A (*e.g.*, "A5").

distributor system which prevails in the alcoholic beverage industries. State courts, acting purportedly in the name of federal antitrust principles but in fact contrary to and without the benefit of the rule-of-reason analysis mandated by this Court in its controlling decision in *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977), would destroy the benefits of heightened interbrand competition which flow from the existing pattern of designated wholesalers. As in other industries, this pattern of distribution exists because it achieves the most effective interbrand competition by holding designated wholesalers responsible for providing the local market services necessary to promote the maximum sales of each brand entrusted to them. As demonstrated by experience in Oklahoma, Minnesota and Kansas, elimination of franchised distributorships results in a substantial reduction in the number of brands available to consumers, the number of retailers serving them, and the number of wholesalers competing for their trade.

The rationale of *Williams* threatens fundamental changes in the structure, competitive tenor and governmental regulation of the alcoholic beverage industries in this country. The outcome of the case is of extraordinary import not only to the WSWA and NBWA members and other participants in those industries but to the states and their regulatory agencies, as well. *Amici* believe that in this brief they will present matters germane to this Court's decision which may not be treated or may not be developed fully by the petitioners because of their differing, although wholly compatible, positions and perspectives.

Statement

Solely upon grounds of asserted repugnancy to federal antitrust law and upon the face of the statute, the Court of Appeal of the State of California, Third Appellate District, enjoined enforcement of the designated wholesaler

or primary source requirement for the importation of distilled spirits enacted by the legislature of that state as §23672 of the California Business and Professional Code. Contrary to the erroneous conclusion of the court below that the California statute it struck down would result in *per se* violation of the Sherman Act, ironically this case in fact mirrors a classic example of the threat to effective interbrand competition posed by the "free rider" problem, analyzed by this Court in *GTE Sylvania.* 433 U.S. 36, 54-55. Provisions of the Oklahoma liquor laws peculiar to that state's regulatory structure have spawned a so-called "Oklahoma connection" which has disrupted and threatened the destruction in other states of free market relationships designed to foster competition and avoid "free riding."

Oklahoma requires that any brand sold to an Oklahoma distributor must be sold, without limitations on quantity, to all other Oklahoma wholesalers and at the lowest price at which it is sold anywhere else. The Oklahoma laws also provide that Oklahoma wholesalers may sell to "qualified persons" outside Oklahoma. Okla. Stats. Ann., Title 37, §§521(e), 533, 536.1. For more than a decade, Oklahoma wholesalers thus have been able to divert unlimited quantities of leading brands to non-franchised distributors in any state which failed to adopt a counteracting designated wholesaler or primary source law. The result was in effect the forced substitution of Oklahoma's prohibition of wholesaler franchising for the traditional freedom of suppliers to deal only with whom they choose, selectively designating wholesalers who undertake and are obligated to perform those functions essential to achieving the most vigorous competition among the myriad brands of alcoholic beverages vying for the consumers' favor.

Since 1972, §23672 or its predecessor has prohibited any California wholesaler from importing into California any brand of spirits unless designated as an authorized importer by the brand owner. These provisions were en-

acted by the legislature to facilitate administration of the state's overall regulatory scheme by stopping the purchase of liquor from Oklahoma wholesalers by parties licensed in California but not designated by the supplier or primary source of the brand.

The respondent wholesalers, the California licensees who challenged §23672, purchased from Oklahoma wholesalers only certain leading, fast-moving, nationally advertised brands in just the most popular container sizes. Enjoying a cost advantage from dealing with accounts taking large-volume deliveries and avoiding the higher expense incurred by the designated wholesalers because of their obligation to carry all sizes of all brands of a supplier and to serve all types of retailers, no matter how distant, small or costly to serve, the non-designated wholesalers profited from the "Oklahoma connection" by "cream-skimming" the lucrative, large account segment of the retail trade. Deprived of that business by prices they could not match, the designated wholesalers' average unit costs were increased both by the substantial reduction in their former volume of business and the higher costs of serving the remaining marginal or less profitable accounts.

A majority of the license states have primary source or designated wholesaler statutes which, like §23672 in California, require, expressly or with the same effect in practical terms, that alcoholic beverages, whether distilled spirits, wine, or others, come directly from the brand-owning supplier (*e.g.*, distiller, rectifier, vintner, brewer, prime importer or other supplier). These suppliers are required to hold licenses or permits and are subject to state regulation and control as a condition to the states' allowing the importation of or sale within their borders of the suppliers' brands.

The primary source statutes advance the legitimate legislative purposes not only of facilitating state control of

alcoholic beverages at all three tiers[3] of the trade but also of orderly, efficient and competitive marketing to provide ready availability of many competing brands in all sizes and at all types of retail outlets, small and large, in sufficiently numerous locations to insure convenient access to consumers and to encourage both price competition and the furnishing of a broad variety of pro-competitive, volume-building wholesaler services. The statutes achieve these objectives by permitting selective franchising by suppliers of designated wholesalers (whether one or several in a given marketing area), who are then obligated to invest their time, effort and money in serving all retail accounts and in furnishing the services necessary to promote sales of a particular supplier's brand in vigorous competition with those of other suppliers, enhancing brand recognition and consumer demand for and satisfaction with that brand.

Using distilled spirits as an example, in that industry, because of the importance of brand recognition in the minds of consumers, it is deemed essential that brands be available in every outlet where they can be placed. The widespread availability and visibility thus achieved both satisfy and augment demand by creating a consumer image of the popularity and quality of the product. In addition to this total account coverage, wholesalers are expected to promote sales volume by obtaining desirable shelf or display space at retail establishments everywhere, educating retailers as to the merits of the brands they represent and persuading them to recommend them to consumers, insuring that full stocks in all sizes are continually and readily available for prompt delivery to retailers wherever located and however

3. The regulatory structures controlling the importation of alcoholic beverages into the states mandate a "three tier" system comprised of separate entities at each of the supplier or producer, wholesaler and retailer levels. Suppliers can sell only to licensed wholesalers and not to retailers. The suppliers, therefore, must look to the wholesalers for the numerous services essential to maximizing the sales volume of their brands in competition with the many brands of competing suppliers.

small, and providing a variety of other services, all of which are designed to build the brand and increase consumer call for it. Even the few brands most heavily advertised by the suppliers cannot achieve their potential without such wholesaler promotional support, which is necessary at the local market level to win retailer and consumer acceptance of the brand and thrust for its advancement.

The primary source requirements allow a supplier to designate selectively and hold franchised wholesalers responsible for securing the broadest possible account coverage and furnishing the most effective promotional services to achieve maximum volume and enhance consumer awareness and demand for the brand. A designated wholesaler must be willing and able to serve the large number of small, distant and marginal accounts, including the lower-volume on-premise consumption outlets such as restaurants, clubs and bars, which are costly to serve[4]; he cannot "cherry-pick" and concentrate solely on the large retail stores, which offer greater profit potential but are unable, alone, to provide the total volume and brand-building consumer awareness which flow from marketwide availability and visibility when the brand is placed and featured in every possible outlet.

The unauthorized wholesaler, on the other hand, has no obligation or incentive to build or maintain any brand. He is interested only in handling those leading brands, whichever they may be at the moment, for which there is the greatest consumer demand—a demand built by the competitive efforts of others. Where unrestrained by a pri-

4. At the same time, the average unit costs of distributing a brand can be lowered when duplication of services, inventory and other expenses is avoided or minimized by the economies of scale which result from placing a brand with one or several but not all wholesalers. These economic factors support the selective distributional patterns which primary source statutes permit as the lowest cost, most efficient means not only to introduce new brands but to keep existing brands in fully effective, vigorous competition with those of other suppliers.

mary source or designated wholesaler statute, the unauthorized wholesaler who obtains such a leading brand elsewhere is free to offer it to just the larger, profitable retailers, neglecting the small, distant and high-cost outlets. The resulting pressure upon a wholesaler designated for that brand destroys his ability to maintain its position. His gross profits decline as the "cream-skimmer" or "free rider" wins sales from the larger accounts. His average unit costs rise as the higher-cost outlets become a greater percentage of his reduced volume, while the "free rider" realizes an increasing cost advantage from concentrating on the larger, profitable outlets. Total account coverage and brand availability, visibility and image suffer as the smaller, distant and high-cost outlets are served inadequately or not at all and as the designated wholesalers cease to provide promotional services they can no longer afford. Market penetration and sales volume for the brand must ultimately decline, and its position deteriorates in relation to that enjoyed in other comparable markets where total account coverage and the promotional services furnished by designated wholesalers are not destroyed by "free riding."

As this Court recognized in *GTE Sylvania*, selective designation of wholesalers and the imposition of vertical restrictions upon where and to whom they can resell (restrictions not required by the primary source law in California and most other states) can maximize sales for a supplier by achieving efficiencies and stimulating the furnishing of competitive services by wholesalers committed to building volume for his particular brand. Such distributional restrictions limit or prevent other "free riding" wholesalers—those who elect not to undertake and bear the cost of promotional, volume-building efforts but choose instead to concentrate upon the large-volume, most profitable accounts—from reaping the benefits of such interbrand competitive activities and destroying the capacity of others to provide such services. "Free riding", by reducing the

volume designated wholesalers sell and their gross profits, prevents them from providing such competitive services because the costs incurred cannot be recovered.

To the extent that the primary source statutes protect them from the "free rider" problem, the franchised wholesalers in the alcoholic beverage industries have been stimulated and enabled to undertake the commitment and cost of furnishing their panoply of volume-building services not only for leading brands but also for newly introduced, less successful or even struggling brands. If the *Williams* decision stands, however, these salutary interbrand competitive activities are doomed in California and seriously threatened in the other primary source states where the mistaken precepts of that decision may be adopted. The "Oklahoma connection" and the peculiarities of that or some other state's probibition upon selective wholesaler franchising will be substituted by erroneous judicial determination for the primary source and designated wholesaler laws, with resulting adverse effect upon the vigorously competitive environment those laws have fostered.

Even a cursory look at the competitive structure of the liquor business in Oklahoma evidences the stultifying effects upon interbrand competition which can be anticipated with the effective elimination of wholesaler designation which the *Williams* decision augurs and the resulting cessation of those volume-building services for which a franchised wholesaler is responsible to the supplier of a brand. Compared to the more than one hundred wholesalers in California, under Oklahoma's no-franchise requirement the number of wholesalers declined from more than twenty to half a dozen, two of whom accounted for 60 percent of all sales there. Posted wholesaler markups have been identical. Hundreds of brands sold in California have been unavailable to consumers in Oklahoma. New brands introduced in California and elsewhere are not distributed in Oklahoma. A few leading, nationally advertised brands command a dispro-

portionately high share of the Oklahoma markets in comparison with their showing in California and other franchise states.

Wholesaler promotional services to build the volume of any brand in competition with those of other suppliers are non-existent in Oklahoma. In essence, competition and consumer demand in that state are determined solely at the distiller level and substantially in terms of only the small number of brands which are nationally advertised. Even those brands fail to reach their maximum potential because of the lack of local wholesaler support. At the consumer level, the trade in the metropolitan areas has been dominated by a few large retailers (one of whom accounts for approximately 10 percent of total sales in the state). Their volume permits them to buy and sell at prices which hold down the number of retailers, because smaller stores cannot compete.

A markedly similar picture has emerged in Minnesota in the last few years since that state adopted a requirement that suppliers sell to all wholesalers, thereby prohibiting designated wholesaler franchises.[5] By contrast, to encourage more effective competition, Kansas has recently substituted an exclusive distributorship requirement for its former law that suppliers must sell to all wholesalers, and there has been a substantial increase in the number of brands available and competing with the leading brands there.

Summary of Argument

As the Solicitor General and the Assistant Attorney General in charge of the Antitrust Division have advised the Court, the decision below, striking down on its face

5. While it requires sales to all wholesalers of any brand sold there, Minnesota, unlike Oklahoma, prohibits Minnesota wholesalers from selling elsewhere unless authorized by the brand owner or supplier. Minn. Stats. Ann., §§340.114 and 340.145.

as a *per se* violation of the Sherman Act California's statute requiring that wholesalers of distilled spirits there must be designated by the brand-owning supplier or primary source, is plainly incorrect. The state court's conclusion that the designation statute purportedly gives unfettered power to suppliers to restrain competition by forbidding unauthorized California wholesalers to buy from Oklahoma wholesalers provides no basis for finding the statute in conflict with the federal antitrust laws.

The designation statute deals only with supplier designation or franchising of wholesalers, simply permitting suppliers to exercise the same freedom enjoyed under the antitrust laws to elect those with whom they will deal in California and, if they choose, to establish a selective distribution system in which the designated wholesalers are responsible for fully promoting a brand in interbrand competition with the many brands of other suppliers. While the statute may enable or facilitate territorial or other vertical non-price restrictions, it does not require them or protect them from antitrust scrutiny. Any such restrictions, however, in view of their salutary potential for enhancing interbrand competition, would require full rule-of-reason evaluation in keeping with this Court's decision in *GTE Sylvania*.

Similarly, the state court's attempted distinction of *GTE Sylvania* as inapposite on the ground that it does not allow a state to authorize suppliers to prohibit non-designated wholesalers from buying from Oklahoma wholesalers or others than the primary source misconstrues that decision. *GTE Sylvania* makes clear that suppliers could impose territorial restrictions upon Oklahoma wholesalers, forbidding them to resell elsewhere, without any *per se* violation of the Sherman Act. Only upon proof by the rule-of-reason standard that an unreasonable restraint of trade resulted from such restrictions could an antitrust violation be found. Only the peculiarities of the Oklahoma liquor laws, which prohibit franchising by requiring sales to all Oklahoma wholesalers and permit them to resell to parties outside that state,

preclude such vertical territorial restrictions, not any federal antitrust rule. In counteracting the extraterritorial impact of the Oklahoma laws within California, the designation statute simply protects the designated wholesalers from "free riders" and allows a supplier to set up selective distribution designed to achieve the most effective interbrand competition for his brand to the same extent permitted by, but without any insulation from the reach of, the federal antitrust laws.

Unless a state statute compels private action in *per se* violation of the antitrust laws, it will not be found to conflict with or be preempted by those laws. The designation statute does not compel or authorize any violation of the Sherman Act. It merely recognizes the traditional right of suppliers to franchise wholesalers selectively. Contrary to the state court's analysis, the statute—not the supplier or any other private party—compels non-designated wholesalers to abstain from dealing with Oklahoma wholesalers or others than the primary source. That statutory requirement does not compel any private action in violation of the antitrust laws.

Even if the designation statute were assumed to violate the antitrust laws, it would not be preempted because, dealing directly with importation and the structuring of the distribution system for distilled spirits within California, it is within the state's virtually complete control. Consequently, no balancing of the state interests advanced by the designation statute with any arguably conflicting federal interest was appropriate. Moreover, in simply gratuitously equating the designation statute with the authorization of private resale price maintenance in *per se* violation of the Sherman Act and without any showing of restraint of trade, the state court, in its purported "balancing," erroneously ignored the fact that even the most restrictive vertical arrangements adopted under the designation statute could stimulate interbrand competition and would be entitled to rule-of-reason evaluation.

ARGUMENT

I

The State Court's Decision Striking Down, on Its Face, the California Designated Wholesaler/Primary Source Statute Because of Alleged Conflict with the Federal Antitrust Laws Is Patently Erroneous and Should Be Reversed.

A. The Statute Neither Requires nor Authorizes Any Violation of the Sherman Act, *Per se* or Otherwise.

Solely on the face of the statute, without examination of any evidence as to the pro-competitive purpose and consequences of wholesaler designation in the distilled spirits industry and without reliance upon any showing of adverse competitive effect,[6] the state court erroneously found that the designated wholesaler/primary source requirement of §23672 is in *per se* violation of the Sherman Act. The court held (A8-A9):

> "The designation statute gives brand owners the unfettered power to restrain competition . . . by merely deciding who may and may not compete. In effect, that statute gives one private party the unlimited power to tell an independent licensed California buyer that he may not buy from an independent licensed Oklahoma seller. A more clear power to restrain interstate trade is difficult to imagine. . . .
>
> ". . . The statute goes much further than to merely allow a manufacturer to determine to whom it will sell; it allows the manufacturer to forbid others to sell to a disfavored importer. . . ."

As the Solicitor General and the Assistant Attorney General in charge of the Antitrust Division concluded in

6. A2 n.1.

their brief, filed in response to the Court's invitation to express the views of the United States as to whether the petitions for *certiorari* should be granted, the decision below "holding that the California designation statute conflicts with Section 1 of the Sherman Act is plainly incorrect." In recognition that the statute requires only supplier designation of wholesalers but not territorial or other vertical restrictions, they stated (Br., p. 8):

> ". . . [T]he non-price vertical restraints that may be facilitated by California's designation statute must be judged under the 'rule of reason.' [citing *GTE Sylvania*] Only by looking at the circumstances of a particular distiller's—or all distillers'—designation of importers could it be determined whether that conduct unreasonably restrains competition in violation of the Sherman Act. Consequently, the Court of Appeal erred in holding that the designation statute, on its face, conflicts with the Sherman Act. Accordingly, the judgment below should be reversed, . . ."

That the California court was misconstruing or failing to note the patent scope of this Court's decision in *GTE Sylvania* is highlighted by its treatment of that controlling precedent (A10):

> "We find the decision in [*GTE Sylvania*] to be inapposite to the statutory provision which we consider. That case involved a manufacturer's chosen method of product distribution enforced by a refusal to sell to retailers outside of their assigned territories. Petitioners herein do not attack the decision of distillers to refuse to trade with them; rather, they attack the state provided authority of the distillers to prohibit them from trading with others. Nothing in [*GTE Sylvania*] authorizes a state to delegate such power to a private party."

This Court's rationale in *GTE Sylvania*, however, clearly was not limited to unilateral refusals to deal with purchasers who disregard a supplier's restrictions upon where or to whom they can resell. By overruling the *per se* holding of *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), the Court unequivocally re-established the proposition that vertical non-price restrictions, including agreements expressly effecting territorial confinement of distributors, require a rule-of-reason evaluation even though solely the result of the private action or agreement of those parties. Such restrictions, the Court concluded, fail to meet the "demanding standards" for invoking the *per se* rules (*i.e.*, a "pernicious effect on competition and lack of any redeeming virtue"). 433 U.S. at 50.

More specifically, in *GTE Sylvania* this Court recognized that vertical restrictions going far beyond a mere refusal to deal other than just with those franchised by or acceptable to the supplier, notwithstanding their reduction or even elimination of intrabrand competition at the level of the distributors, can enhance competition overall by stimulating the designated distributors to provide procompetitive promotional services which heighten the thrust of the supplier's products in interbrand competition with those of competing suppliers.[7] 433 U.S. at 50-59.

In short, the state court's conclusion that *GTE Sylvania* is inapposite to its determination that California's designation statute violates the Sherman Act because it delegates to private parties "the unfettered power to restrain competition" by allowing "manufacturers to forbid others to sell to a disfavored importer" squarely conflicts with

7. Interbrand competition, the Court declared, is the "primary concern of the antitrust laws" and the ultimate protection of consumers, because without it no amount of intrabrand competition can insure the availability of substitute competing products and the "significant check on the exploitation of intrabrand market power" thus provided by the existence of interbrand competition. 433 U.S. at 52 n.19.

what this Court in fact decided in *GTE Sylvania*.[8] Without any *per se* violation of the antitrust laws, suppliers in the alcoholic beverage industries could condition their sales to Oklahoma wholesalers, vertically restricting and forbidding them to resell outside that state. *GTE Sylvania* would require proof by the rule-of-reason standard that an unreasonable restaint of trade resulted from any such restriction before an antitrust violation could be found.[9] Indeed, in their brief (p. 13) opposing the petitions for *certiorari*, respondents concede that *GTE Sylvania* "may well allow a distiller to prohibit his own franchisee from reselling his brand to a third party in another state." Only the peculiarities of the Oklahoma liquor laws, therefore, but not any principle of federal antitrust law, prohibit suppliers from imposing such territorial restrictions upon Oklahoma wholesalers.

The California designation statute simply nullifies in that state the intrusion of the Oklahoma laws. In effect, by counteracting the Oklahoma prohibition upon franchising, the California legislature merely (1) preserved the freedom of suppliers recognized under the federal antitrust laws to

8. In holding that the designated wholesaler requirement of the California statute, on its face, constitutes a *per se* violation of the Sherman Act, the state tribunal ignored the teaching of this Court that before conduct can be characterized as subject to any *per se* rule "inquiry must focus on whether . . . the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, . . . or instead one designed to 'increase economic efficiency and render markets more, rather than less, competitive.'" *Broadcast Music, Inc.* v. *Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19-20 (1979).

9. Supplier refusals to sell for resale outside a given area in order to avoid the disruptive effect on their marketing operations in other areas in which they maintain exclusive or selective distributorships have been sustained. See, *e.g.*, *Naify* v. *McClatchy Newspapers*, 599 F.2d 335 (9th Cir. 1979). *Cf. Dakota Wholesale Liquor, Inc.* v. *State of Minnesota*, 457 F.Supp. 480 (D. Minn. 1978), *aff'd per curiam*, 584 F.2d 847 (8th Cir. 1978) (denial of preliminary injunction).

choose California wholesalers selectively[10] and (2) protected the designated California wholesalers from unauthorized "free riders" to the same extent that the suppliers—without any arguable *per se* violation of the Sherman Act—could protect them by means of territorial restrictions on wholesalers elsewhere. The California law simply enables suppliers to establish in that state a distributional structure neither less nor more restrictive than permitted by the Sherman Act.[11]

That the California court was clearly incorrect in determining that the designation statue is in *per se* violation of the Sherman Act is supported by this Court's decision just last Term in *Grant-Billingsley Wholesale Liquor Co., Inc.* v. *Lennen*, 449 U.S. 943 (1980) (No. 80-189). Reviewing a decision of the Kansas Supreme Court[12] which upheld, on the basis of the Twenty-first Amendment and also as not repugnant to the federal antitrust laws and Constitution, a far more restrictive primary source requirement

10. See, *e.g., Schwinn, supra*, 388 U.S. at 376 (". . . A manufacturer of a product, other and equivalent brands of which are readily available in the market, may select his customers, and for this purpose he may franchise certain dealers to whom alone he will sell his goods . . .").

11. The California court's statements, repeated throughout its opinion, that §23672 gives to suppliers or brand owners an unfettered or unqualified power to restrain trade and that their decisions are "final" disregard the availability of federal antitrust suits. Neither the California statute nor the primary source requirements of most of the other states even purport to immunize selective wholesaler designation or franchises, let alone any vertical restrictions upon resale, from the antitrust laws. If any such arrangements result in an unreasonable restraint of trade, then antitrust actions in federal court, with a full rule-of-reason evaluation, are available to private parties and government enforcement officials, just as is the case with respect to the provisions of Section 2(a) of the Robinson-Patman Act (15 U.S.C. §13) that nothing therein shall prevent sellers "from selecting their own customers in bona fide transactions not in restraint of trade. . . ."

12. *Colby Distributing Co., Inc.* v. *Lennen*, 227 Kan.2d 179, 606 P.2d 102 (1980), *appeal dismissed sub nom. Grant-Billingsley Wholesale Liquor Co., Inc.* v. *Lennen*, 449 U.S. 943 (1980).

than that of the California statute at issue here, the Court dismissed the appeal for want of a substantial federal question. While §23672 permits intrabrand competition in that a supplier is free to designate more than one wholesaler in any marketing area and the statute neither imposes nor requires any limitations upon the territory served by any wholesaler, the Kansas statute, in addition to providing that no wholesaler is to sell a brand other than pursuant to a written agreement with the supplier, also prohibits all intraband competition between wholesalers. The Kansas statute mandates that the territory within which the designated wholesaler is authorized to sell is to be specified and that no supplier can "grant a franchise for the distribution of a brand to more than one distributor for all or part of any designated territory." Kan. Stats. Ann., §§41-101, *et seq.*

On appeal to this Court, the parties challenging the Kansas statute urged, as they had before the state courts, that its delegation of authority to private parties to establish exclusive, territorially confined distributorships was in *per se* violation of the Sherman Act. Those *per se* contentions were rejected by the Kansas Supreme Court. If the summary dismissal of the appeal from *Colby* for lack of a substantial federal question was not solely upon Twenty-first Amendment grounds, then this Court, too, rejected *per se* contentions of the very same character asserted by the respondents in this case and erroneously adopted by the California court.

B. Because the Statute Compels No Action by Private Parties in *Per se* Violation of the Antitrust Laws, the State Court Erred in Finding It Repugnant to the Sherman Act.

WSWA and NBWA submit that §23672 does not purport to authorize or mandate any violation of the Sherman Act. Without exception, the decisions of this Court establish that

in order to find a state statute repugnant to the antitrust laws it must compel action by private parties which is a *per se* or other clear violation. In another case involving a challenge to state liquor regulations based upon alleged Sherman Act grounds, *Joseph E. Seagram & Sons, Inc.* v. *Hostetter*, 384 U.S. 35, 45 (1966), this Court declared:

> "In this as in other areas of coincident federal and state regulation, the 'teaching of this Court's decisions . . . enjoin[s] seeking out conflicts between state and federal regulation where none clearly exists.' *Huron Cement Co.* v. *Detroit*, 362 U.S. 440, 446. We find no such clear conflict in the present case. . . . [The state regulation] imposes no irresistible economic pressure on the appellants to violate the Sherman Act in order to comply with the requirements of [the state regulation]."

By contrast, in the recent case of *California Retail Liquor Dealers Ass'n.* v. *Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), the Court upheld a line of California state court decisions[13] striking down California's price posting requirements for wine and spirits. Those decisions, however, involved California's total delegation to private parties of the unsupervised power to set minimum resale prices to be charged by the purchasers of their brands. Such vertical price-fixing, lacking even the pretense of state review or involvement, constituted a *per se* violation of the Sherman Act on the face of the statutes and without more.

The designation statute, contrary to the requisites for finding conflict with the antitrust laws, wholly fails to compel any private action in *per se* violation of the antitrust laws. Indeed, as the Solicitor and Assistant Attorney Gen-

13. See *Rice* v. *Alcoholic Beverage Control Appeals Board*, 21 Cal.3d 431, 146 Cal. Rptr. 585, 579 P.2d 476 (1978); *Capiscean Corp.* v. *Alcoholic Beverage Control Appeals Board*, 87 Cal. App.3d 996, 151 Cal. Rptr. 492 (1979); *Midcal Aluminum, Inc.* v. *Rice*, 90 Cal. App.3d 979, 153 Cal. Rptr. 757 (1979).

eral noted (Br., pp. 12-14), "... contrary to the conclusion of the Court of Appeal . . . , the primary thrust of the designation statute merely is to recognize the inherent right of *any* manufacturer to select or franchise wholesalers through whom its products will be sold or distributed." Recognizing that not even those territorial restraints which can be found to violate the Sherman Act only upon a full rule-of-reason evaluation are required by the statute, they concluded:

> "Because the designation statute does not require a brand owner to impose vertical restraints of a kind that may violate the Sherman Act, the fact that a particular brand owner might abuse its powers in imposing such restraints (and might rely on the designation statute to police them) is not a basis for invalidating the statute on its face. . . .
>
> "Thus, because the designation statute, unlike the resale price maintenance statute involved in *Midcal*, does not compel the conduct that is asserted in this case to be in violation of the Sherman Act, the Court of Appeal erred for this reason alone in holding that the designation statute on its face conflicts with the Sherman Act. . . ."

Similarly, the state court's characterizations that in effect the "statute gives one private party [the supplier] the unlimited power to tell an independent licensed California buyer that he may not buy from an independent licensed Oklahoma seller" and "allows the manufacturer to forbid others to sell to a disfavored importer" do not square with what in fact the statute compels. All that the statute requires of a supplier who wishes to have his brand qualify for importation into California is his designation of one or more wholesalers, whether ten, twenty or each and every wholesaler licensed by the state. The statute merely recognizes the right universally enjoyed by suppliers (ab-

sent statutes such as those in Oklahoma and Minnesota) to elect with whom they will deal. The supplier does not forbid any California or Oklahoma wholesalers to deal with each other. Rather it is the legislature and the statute itself which forbid such dealing, and that statutory compulsion upon unauthorized California wholesalers simply does not compel the kind of action by private parties which violates the Sherman Act.

Unless overturned, the much-publicized and erroneous decision by the California court may have substantial, far-reaching precedential impact elsewhere in view of the similar designated wholesaler and primary source laws which exist in a majority of the license states.[14] Based upon the incorrect application by the California court of principles of federal antitrust law, pre-emption and supremacy, the primary source requirements of other states have been challenged in pending litigation and the filing of additional suits asserting the same claims and raising the same issues is likely unless the Court repudiates the erroneous rationale of the decision below.[15]

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14. In their brief (p. 20 n.18), the Solicitor and Assistant Attorney General express their belief that the opinion below does not call into question the primary source laws in other states which require an in-state wholesaler to purchase directly from the distiller inasmuch as the wholesaler designation statutes, such as California's, do not require the authorized wholesaler to "purchase the brand only from the distiller, as would be the case under a primary source law." *Amici* submit, however, that in purpose and practical effect the two types of statute are so essentially alike that the erroneous rationale of the court below could be applied to either by a state court mistakenly adopting it. A primary source law gives brand owners just as much "power to tell an [unauthorized but licensed in-state wholesaler] that he may not buy from an independent licensed Oklahoma seller" as does a designation statute.

15. *H&H Distributing Company, Inc.* v. *Mississippi State Tax Commission, et al.*, Civil No. J80-0323 (N), S.D. Miss. (Jackson Div.); *Mile Hi Wholesale Liquors, Inc.* v. *Alan Charnes, Executive Director of the Department of Revenue, State of Colorado*, Case No. 80 C.V. 8844, Dist. Ct., City & County of Denver, State of Colorado.

II

Even if in Violation of the Antitrust Laws, the Designation Statute Was a Valid Exercise of California's Virtually Complete Control Under the Twenty-First Amendment of the Importation and Structuring of the Distribution System for Intoxicating Beverages.

The decision below also disregards the long-standing construction of the extent of the power granted to the states by the Twenty-first Amendment to control the importation and structuring of the distribution of intoxicating beverages within their borders. Even if the California and other designated wholesaler or primary source laws violated the Sherman Act, as the state court mistakenly concluded, any claim of federal pre-emption would fail because of that broad power. Section 2 of the Amendment provides that "The transportation or importation into any State . . . for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

The California court rejected the applicability of the Amendment without analysis other than its *ipse dixit* that "the designation statute does not relate to the decision whether to permit the importation and sale of liquor and is not a part of the establishment of the channels of distribution." Concluding instead that the state's interests, allegedly in conflict with the competitive objectives of the Sherman Act, were of the type which, "like the price maintenance laws," must be reconciled with those federal interests (A12), the court applied its own mistaken balancing test and found the state interests lacking. This determination is wholly at odds with the long line of Twenty-first Amendment decisions of this Court, including *Midcal, supra.*

From its adoption, the Twenty-first Amendment has been accorded a broad sweep by this Court. Particularly germane are several decisions which demonstrate that the

designation statute falls within the state's virtually complete control over importation and structuring of the distribution system and, therefore, unlike any delegation of private price-fixing authority, requires no balancing with any conflicting federal interest even if such an opposing interest were assumed to exist on the facts of this case. Dir tly contrary to the conclusions of the court below, for example, is the characterization by Justice Brandeis in *State Board* v. *Young's Market Co.*, 299 U.S. 59, 63 (1936), "Can it be doubted that a State might . . . channelize desired importations by confining them to a single consignee?" As Justice Black stated in his dissenting opinion in *Hostetter* v. *Idlewild Liquor Corp.*, 377 U.S. 324, 339 (1964):

> ". . . [T]his Court in *State Board* v. *Young's Market Co.* . . . said that a State is perfectly free to set up a state liquor monopoly or to confer a liquor monopoly upon some one dealer in the State. It is equally obvious that New York is free to allow only a limited number of dealers to engage in the liquor business. It might do this because it wanted to discourage consumption, or to make it easier to police the liquor traffic, or to accomplish some other objective the State thought worthwhile to protect against the evils which can flow from the traffic. In particular, New York might want to see that sales are not diverted to Idlewild from other dealers licensed and regulated by the State."

Based upon the Twenty-first Amendment, in *Heublein, Inc.* v. *South Carolina Tax Commission*, 409 U.S. 275 (1972), the Court sustained a South Carolina requirement that producers could ship alcoholic beverages into that state only to an employee located there. The Court held that the requirement that the sales be localized in South Carolina was an appropriate exercise of the state's power under the Twenty-first Amendment and was not merely a subterfuge to subject out-of-state sellers to taxation contrary to the

provisions of 15 U.S.C. §381. Reiterating that "by virtue of [the provisions of the Twenty-first Amendment] a State is totally unconfined by traditional Commerce Clause limitations when it restricts the importation of intoxicants destined for use, distrubtion or consumption within its borders" (409 U.S. at 283), the Court concluded that the South Carolina requirement did not violate the Commerce Clause. Just as the designated wholesaler or primary source requirements in California and elsewhere are part of overall, complex and integrated regulatory schemes of similar character, the South Carolina local sale requirement was evaluated by the Court as an integral part of the total regulatory structure of that state:

> "South Carolina's Alcoholic Beverage Control Act is a long and detailed statute. Requirements that certain records be kept by the manufacturer, the wholesaler and the retailer pervade the scheme. There must be complete records of the quantities, brands, and prices involved at every stage of each liquor sale. By requiring manufacturers to localize their sales, South Carolina establishes a check on the accuracy of these records. . . .
>
> "The requirement that before engaging in the liquor business in South Carolina a manufacturer do more than merely solicit sales there is an appropriate element in the State's system of regulating the sale of liquor. . . ." 409 U.S. at 282-283.

By analogy, California should be free to require purchases only from the primary source suppliers accountable to the state and to exclude sales by Oklahoma wholesalers not subject to the same responsibilities and controls.

More recently, in *Midcal*, this Court reiterated that "the Twenty-first Amendment grants the State virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system."

Other types of alcoholic beverage regulation, while substantially within the discretion of the states, may be subject to the commerce power in appropriate situations, and then a balancing of the competing state and federal interests becomes necessary in evaluating such regulations.[16] Thus, while the federal government retains some Commerce Clause authority over intoxicating beverages, as this Court's decisions demonstrate, restrictions upon importation and the structuring of their distribution systems are a matter of "virtually complete control" by the states.

Even as to those regulations directed to matters other than importation and the structuring of the distribution system and which require a balancing of any conflicting federal interests, the extent to which the authority granted to the states by the Twenty-first Amendment must be weighed in favor of such regulations is delineated by *Midcal*, was disregarded by the court below, and places its decision in sharp conflict with *Midcal* and the earlier decisions of this Court.

The clear federal interest at issue in *Midcal* was price competition and the *per se* outlawing of private vertical price-fixing—an interest of paramount importance to the competitive objectives of the Sherman Act and involving conduct determined to be without justification or defense because of its "pernicious effect on competition and lack of any redeeming virtue." This prime federal competitive goal was opposed only by California's claimed interest in temperance and the preservation of small retailers against their larger competitors. In *Midcal*, however, California had "shown less than an enthusiastic interest in its wine pricing system" (445 U.S. at 111 n.12), and there were

16. "The Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system. Although States retain substantial discretion to establish other liquor regulations, those controls may be subject to the federal commerce power in appropriate situations. The competing state and federal interests can be reconciled only after careful scrutiny of those concerns in a 'concrete case.'" 445 U.S. at 110.

evidence and findings both by California's administrative agency responsible for alcoholic beverage control and by its courts that in fact the asserted state interests were not advanced by resale price-fixing. Emphasizing the importance of preserving the regulatory power granted to the states, this Court noted that "the findings and conclusions of [the California] courts are not binding on this Court to the extent they undercut state rights guaranteed by the Twenty-first Amendment." Nevertheless, on the record there was no basis for disagreeing with the California courts' conclusions, which were reasonable and supported by the only evidence of record:

> "... Nothing in the record in this case suggests that the wine pricing system helps sustain small retail establishments. Neither the petitioner nor the State Attorney General in his *amicus* brief has demonstrated that the program inhibits the consumption of alcohol by Californians."

With no basis for supporting the claimed state interests, therefore, this Court ruled that the "unsubstantiated state concerns put forth in this case simply are not of the same stature as the goals of the Sherman Act" and "the Twenty-first Amendment provides no shelter for the violation of the Sherman Act by the State's wine pricing program." 445 U.S. 111-114.

The implication of the *Midcal* analysis is that, even where vertical price-fixing was the subject of regulation rather than importation and structuring of the distribution system, this Court would not be bound by state court findings undermining the state's "substantial discretion" under the Twenty-first Amendment unless the record was devoid of any basis for sustaining the state's interests and power. Unlike the conclusions based upon uncontradicted evidence of record in *Midcal*, here the court below decided solely upon the face of the statute and without reliance upon any evidentiary showing that the designated statute failed to serve legitimate interests in California.

In conflict with the rationale set forth in *Midcal,* and even though a regulation more clearly directed to importation and structuring of the distribution system than the California designation statute would be difficult to conceive, the court below expressly rejected the contention that the California designated wholesaler/primary source statute "is within the state's virtual complete control over whether to permit importation or sale of liquor and how to structure the distribution system." On that erroneous predicate, purporting then to balance the allegedly competing state and federal interests, the California court, with no analysis other than its equating the wholesaler designation statute with "the price maintenance laws" previously overturned, initially placed upon the federal tray of the scale a conclusion defying any possible counter-weight: "The grant of power to a private party to prohibit interstate commerce between other private parties and to limit competition in the California wholesale market results in a complete undermining of the federal policies embodied in the Sherman Act." Understandably, thereafter, the court totally dismissed any state interests "purportedly served by the designation statute," including facilitating the monitoring and tracing of distilled spirits, aid in the collection of excise taxes, maintenance of the three-tier system of distribution, and preserving the competitive viability of small retailers. A12-A14.

Even if it were assumed that §23672 somehow violates the Sherman Act, it is clear, for the reasons discussed in the preceding section of this brief and analyzed by this Court in *GTE Sylvania,* that even the most restrictive vertical arrangements any supplier could adopt under the aegis of that statute might stimulate trade and commerce by promoting vigorous interbrand competition. There can be no reasoned basis, therefore, for the lower court's conclusion, without benefit of any evidentiary showing, that the designation statute completely undermines the federal policies of the Sherman Act or that it fails to vindicate the legitimate state interests dismissed by the court.

In its dismissal of the appeal from the Kansas Supreme Court's decision in the *Colby* case for want of a substantial federal question, this Court presumably concluded either that the far more restrictive primary source statute there did not violate the Sherman Act or that the Twenty-first Amendment reserves to the states the power to enact such regulations. While the absence of any basis for the Sherman Act claims there or here seems so apparent, if this Court dismissed the appeal in *Colby* on Twenty-first Amendment grounds, then the decision below presumably conflicts with the view of the Amendment applied by this Court in reviewing that case.

Conclusion

For the reasons stated, the judgment below should be reversed.

Respectfully submitted,

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